

## Why Are Government Sponsored Enterprises (GSEs) Important?

The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) are Government Sponsored Enterprises (GSEs) established to facilitate mortgage lending. Both institutions purchase conforming mortgages, which meet dollar limit and credit soundness requirements, from banks and other financial intermediaries. The GSEs then market the mortgages in bundled packages of securities. Both institutions were established to overcome historical limitations in nation's financial system that led to credit crunches in local and regional mortgage markets. Freddie and Fannie provide stability in the secondary market for residential mortgages, and promote access to mortgage credit throughout the nation by increasing the liquidity of mortgage investments and the availability of capital. Fannie and Freddie issue mortgage backed securities, pools of mortgage loans consolidated into securities, which are sold in the financial markets. In this way, Fannie and Freddie act as a conduit for the flow of capital into the housing markets.

The Office of Federal Housing Enterprise Oversight, OFHEO, an independent office in the Department of Housing and Urban Development, regulates Fannie and Freddie. OFHEO has statutory responsibility for ensuring that the companies are adequately capitalized and operating in a safe and sound manner. OFHEO conducts examinations of the financial health of the companies and required capital standards.

As GSEs Fannie and Freddie have the ability to borrow large sums of money in the credit markets at relatively lower rates of interest than would otherwise be the case. Fannie and Freddie have two means of channeling funds from the capital markets to retail lenders:

- Invest in mortgages: issue debt obligations and purchase mortgages. When enterprises buy and hold mortgage assets in portfolio, they are retaining interest rate, prepayment, and credit risks.
- Guarantee mortgage backed securities: Pool individual mortgages, insure the pools against credit risk, sell the undivided interest in the pools directly to investors in the form of MBS. Ultimately, the GSEs retain the credit risk.

Fannie and Freddie are huge:

- As of December 2007, the Mortgage Backed Securities issued by Freddie and Fannie were a total of \$3.5 trillion, and their retained portfolio of securities was \$1.4 trillion.
- Freddie and Fannie accounted for 75.6 percent of mortgage originations in 2007.
- Both enterprises are highly leveraged. As of Q42007 Fannie and Freddie had a ratio of mortgage book of business over core capital of 64 times and 56 times, respectively.

Fannie and Freddie are the largest GSE's, formed to enhance the flow of credit to targeted sectors of the economy and reduce the cost of credit. Other GSE's include the Federal Agricultural Mortgage Corporation, "Farmer Mac", and the Federal Home Loan Banks.